

**Opinion of the European Economic and Social Committee on the Proposal for a directive of the European Parliament and of the Council on the taking up, pursuit and prudential supervision of the business of electronic money institutions, amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC**

COM(2008) 627 final — 2008/0190 (COD)

(2009/C 218/06)

On 30 October 2008 the Council decided to consult the European Economic and Social Committee, under Article 47, point 2, first and third sentence, and article 95 of the Treaty establishing the European Community, on the

*'Proposal for a directive of the European Parliament and of the Council on the taking up, pursuit and prudential supervision of the business of electronic money institutions, amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC'*

The Section for Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 3 February 2009. The rapporteur was Mr MORGAN.

At its 451st plenary session, held on 25 and 26 February 2009 (meeting of 26 February), the European Economic and Social Committee adopted the following opinion by 156 votes to 1 with 10 abstentions.

## 1. Conclusions and recommendations

1.1 With the progressive application of electronic data processing to financial services one might conclude that we already have electronic money. Cheques are read and sorted electronically and debit and credit cards are read electronically by ATMs, point of sale terminals and other types of payment devices. All of these applications are based on the credit available in a bank account which may be limited by deposits or determined by the bank (e.g. for credit cards). In all cases the bank has made the investigation to determine its client's credit worthiness and bona fides and has issued chequebooks and debit and credit cards accordingly. Access to this electronic credit system depends on credit worthiness. Many sections of the community – the unbanked or the underbanked – are not eligible to participate.

1.2 Electronic money (e-M) is different. It does not depend on credit. It requires a prepayment. The prepayment is then converted into an electronic surrogate for cash stored on electronic media which are managed by an e-M issuer. The electronic media which contains the prepayment may be either portable, which usually take the form of a prepaid card, or they may be on line records and accessed via the internet. E-M enables cashless payments of (generally) smaller amounts in diverse environments such as points of sale or on line through mobile or internet communications. The possession of e-M is not directly linked to credit worthiness. All that is required is the capacity to make the prepayment.

1.3 E-M is never likely to fulfil all the needs which money satisfies. It is not likely to replace the box of EUR 500 notes kept under the bed but it should be able to handle the transactions for which we carry coins and notes on our persons. Even so, the take up so far has been very slow. Successful initiatives have been linked to information society developments. E-M should advance in parallel with the information society. It should be the money of the information society. Future take up will depend on entrepreneurial initiatives and technical innovation in the information society. The purpose of this Directive is to remove obstacles to invention and innovation. The EESC supports this objective.

1.4 In the late 1990s the European Commission saw that issuers of electronic money were confined to credit institutions, and sought to widen the scope of businesses offering these services. In order to develop the market, the Commission introduced E-Money Directive (2000/46/EC) (EMD) to facilitate access by non-credit institutions (e-M institutions) to the e-M market.

1.5 The objective of the EMD was to create a regulatory regime appropriate to the scale of risk represented by the new e-M institutions and under which technology and innovation could flourish. The outcome has not been a great success. E-M is still far from delivering the full potential benefits that were expected and it is not yet considered to be a credible alternative to cash.

1.6 As a result, the Commission has undertaken a wide ranging review of e-M developments. It has concluded that some of the provisions of the EMD have hindered the development of the e-M market, hampering technological innovation. The consultation and evaluation process identified two main concerns. The first involved the unclear definition of e-M and the scope of the EMD. The second concern related to the legal framework which involves the prudential regime and the application of anti-money laundering rules to e-M services. The conclusion was that most of the provisions of the EMD need amending, so it was decided to replace the existing Directive with a new Directive the draft of which, COM(2008)627 final, is the subject of this Opinion.

1.7 The aim of this Directive is to enable new, innovative and secure e-M services to be designed, to provide market access to new players and to foster real and effective competition between all market participants. In the view of the EESC, this initiative is timely because consumer engagement with the information society has increased exponentially since the end of the last decade and there is now a pent up and unsatisfied demand for consumer friendly e-M facilities. The Directive seeks to remove obstacles to the entrepreneurial initiatives which can satisfy that demand.

1.8 The introduction of a new regulatory regime in the financial sector is a potential issue in view of the crisis in the banking system and the general concern about the ineffectiveness of the regulation of banks. Notwithstanding these concerns, the EESC is satisfied that the proposed regime is adequate and proportionate. The new regulations do not apply to banks which were the Institutions responsible for the credit crisis; the drop in the initial capital requirement only serves to reduce the barriers to entry; the capital reserves of an e-M Institution will be proportional to those of the banks; funds representing user claims will be specifically safeguarded in a limited range of investments; the amounts of money involved are de minimis. Should e-M institutions become a real force in the payments market, there are provisions in the Directive to modify it in the light of experience.

1.9 The EESC has some concerns about consumer protection and it urges the Commission to make changes to the Directive in respect of limitations on the investment of the float, the immediate conversion of sums received into e-M, safeguarding the float in hybrid institutions and removing the fee for early redemption of e-M contracts.

1.10 Cash is anonymous. Simple cash transactions do not reveal the identity of the person making the payment. e-M schemes may be anonymous or identified. The higher stored value limit of EUR 500 should make e-M more attractive to potential users, especially the unbanked and underbanked. While rationally these limits should not represent a disproportionate exposure to money laundering, relative to what is possible with large sums of cash, some reservations remain about the limit proposed.

1.11 Coins and notes have a production cost and a handling cost for banks and merchants. It is evident that the EU public remains wedded to cash as a means of payment and a store of value. In the present period of uncertainty there is a huge increase in the number of bank notes in circulation.

1.12 On its own, this Directive will not turn the tide. What it will do is remove barriers to business and technological innovation. No authority can mandate the use of e-Money by the general public. The banks are in a position to take a lead but outside of Belgium with its Proton card, they have not made very much progress. The evidence from travel cards, phone cards and internet commerce clearly shows that information society applications have a tendency to extend the use of e-M. In addition, e-M is often the product of another business so the issuer may often be a hybrid undertaking and not dedicated to e-M alone. This linkage between e-M and other business models is seen to vital for the emergence of e-M. The Directive has been drafted to facilitate such developments and so it has EESC support.

1.13 A fundamental concern relates to the development of anti money laundering regulations. The EESC cannot accept that two directives set contradictory limits. This creates unacceptable legal confusion. If the limits stated in this Directive are to prevail, then the AML Directive must be modified.

1.14 The EESC urges all Member State to adopt positive policies when implementing the new Directive. It is important that the regulations are developed in consultation with the industry and that they be framed in such a way that they do not represent an onerous burden on either e-M issuers or their clients while the sums of money involved are minimal. According to the approach adopted, national authorities have it in their power to either support or suppress this fledgling industry. The EESC believes that the industry should be supported in all Member States.

1.15 This Directive is important. It has potentially far reaching implications. The EESC urges the present and potential actors in the e-M arena to re-evaluate their strengths, weaknesses, opportunities and threats in the light of this Directive. The market is being given a second chance.

## 2. Introduction

2.1 Paragraphs 2.2, 2.3 and 2.4 explain the main features of electronic money (e-M) and its linkage to the information society. There are a number of examples of the way in which consumer involvement with the information society is leading to the adoption of e-M.

2.2 Usage of the RFID <sup>(1)</sup> card is a case in point. The RFID chip can record monetary values and so a common application is payment for access to transport systems. Hong Kong introduced the Octopus card in 1997. It is a rechargeable contactless stored value smart card. Apart from being used as a payment system for nearly all public transport in Hong Kong, it is also used for payment at convenience stores, supermarkets, fast food restaurants, on street parking meters, vending machines, etc. The cards are used by 95 % of the population of Hong Kong aged 16 to 65. This example shows how the engagement of the consumer with an information society application leads to the wider development of e-M. London now has the Oyster contactless RFID card in general use for public transport. Users now anticipate its extension to the news agents, convenience stores and fast food outlets which cluster around transport hubs and stations. Such developments are certain to take place in both the UK and other Member States as RFID cards come to be widely adopted.

2.3 Another more wide spread example is the prepaid mobile phone account which can already be used to pay for activities as diverse as help lines for computer problems, competition entries, charitable giving, interactive games, adult entertainment and news and information services. As in the case of prepaid travel cards, prepaid phone accounts are defined as e-M when the stored value begins to be accepted by businesses other than the transport or telephone operator.

<sup>(1)</sup> RFID – Radio Frequency Identification – uses an electronic chip which may be incorporated into various media such as article identity tags or personal identity cards. The chip is read by a wireless reader and the card need only touch the reader. This application is described as 'contactless'. Building access cards such as those at the EESC are RFID cards.

2.4 The internet also promotes e-M because e-M can satisfy two important needs. Most business to consumer applications on the internet involve a credit transaction. The unbanked are automatically excluded because they have no credit or debit card. By using an e-M card they can profit from internet benefits. There has also been a significant growth in Consumer to Consumer (C to C) transactions on the internet, stimulated by auction houses such as E-Bay. It is not possible to conduct a C to C credit or debit card transaction. The payment must be in secure e-M. This accounts for the emergence of systems such as PayPal <sup>(2)</sup> which has had a symbiotic relationship with E-Bay.

2.5 The evidence from travel cards, phone cards and internet commerce shows that information society applications extend the use of e-M. It also shows that e-M can be the by-product of another business so the e-M issuer may often be a hybrid undertaking. This linkage between e-M and another business is seen to vital for the emergence of e-M. The Directive has been drafted accordingly.

2.6 Credit Institutions such as Banks have all the necessary attributes to be e-M issuers and they operate under appropriate regulatory regimes. To some degree, credit institutions have taken the initiative. The Proton card in Belgium is the product of a banking consortium. It combines a debit card with a money card function and is in widespread use in Belgium amongst bank customers. There is some prospect that more such combined cards with a contactless e-M function based on RFID technology will come into circulation. Even so, there is an evident conflict of interest between e-M and other product lines of credit institutions such as credit and debit cards.

2.7 Figures on the limited number of fully licensed e-M institutions (20 e-M institutions and 127 entities operating under a waiver) or on the low volume of e-M issued (currently the total amount of e-M in the EU amounts to EUR 1 billion in comparison with more than 600 billion in cash) demonstrate that e-M has not yet taken off in most Member States. In addition, the amount of cash in circulation has risen steadily since the introduction of the Euro in 2002.

<sup>(2)</sup> PayPal started as an e-M Institution regulated by the UK FSA. It has since converted into a Credit Institution and is now domiciled in Luxembourg.

2.8 As a result, the Commission has undertaken a wide ranging review of e-M developments. The consultation and evaluation process identified two main concerns with the existing EMD. The first involved the unclear definition of e-M and the scope of the Directive. The second concern related to the legal framework involving the prudential regime and the application of anti-money laundering rules to e-M services.

2.9 In addition, the Payment Services Directive (PSD) 2007/64/EC will come into force by November 2009. The relevance of the PSD is that it establishes a special regime for payment institutions analogous to the regime for e-M institutions. The PSD is not compatible with the EMD so unless the current EMD regime is revised this will, in due course, add to the legal uncertainty.

2.10 The outcome of all of the above is that most of the provisions of the EMD need amending, so it has been decided to replace the existing directive with a new Directive the draft of which is the subject of this Opinion.

### 3. Gist of the Directive

3.1 The aim of the Directive is to enable new, innovative and secure e-M services to be designed, provide market access to new players and foster real and effective competition between all market participants. It is expected that innovation in the payments market will create tangible benefits for consumers, businesses and the wider economy while creative solutions should promote rapidity of payments, convenience of use and new functionalities for the e-society of the 21<sup>st</sup> century.

3.2 The definition of e-M is clarified: 'electronic money' means a monetary value as represented by a claim on the issuer which is stored electronically and issued on the receipt of funds (Article 2.2). It does not apply to single purpose (closed loop) pre-paid instruments that can only be used in a limited way (Article 1.3, 1.4).

3.3 The scope of the new Directive facilitates market entry because it applies to issuers of multipurpose (open loop) electronic vouchers such as RFID cards and mobile phone cards and it does encompass server based e-M.

3.4 The activities of e-M institutions are more broadly defined in Articles 8 and 9. There are two dimensions. The first states that a broader range of payment services, as defined in the annex to the PSD, may be offered, including

the granting of credit, the provision of ancillary services and the operation of payment systems. The second recognises that e-M issuers may undertake other activities such as retail or telecom in the normal course of business. In these latter cases it will no longer be necessary to create an arms length e-M institution. What will be needed is that the e-M funds are safeguarded in accordance with the provision of the PSD. The authorisation of such hybrid e-M institutions should promote an increase in e-M issuance.

3.5 Rights of redemption are a consumer protection feature. They are clarified in Article 5: Member States shall ensure that, upon request of the holder, issuers of electronic money redeem, at any moment and at par value, the monetary value of the electronic money held. This provision has caused problems for mobile phone operators where the prepayment was for phone services with the option of retail use but they are now covered by the provisions of Article 5.

3.6 The prudential regime generally follows the provisions of the relevant articles of the PSD. However, there are specific provisions to make the regime proportional to the risks involved. There are a number of aspects.

3.6.1 The EMD stipulated that an e-M institution should have an initial capital of EUR 1 million. This is now seen to have been excessive in relation to the risks involved and an obstacle to the formation of innovative SMEs in the e-M space. In the new draft, initial capital required is reduced to EUR 125 000.

3.6.2 In addition to the initial capital, e-M institutions must hold a float (own funds) as a proportion of their outstanding liabilities. In the EMD this was 2 %. The new requirement is 5 %, reducing as the volume grows, on the higher of the outstanding value or the monthly payments volume.

3.6.3 There are limitations on the investment of float funds representing outstanding electronic value, but only where the issuer undertakes non-payment business (Article 9).

3.6.4 The proposed anti money laundering amendments to the Third Money Laundering Directive regime are consistent with the needs of business, and industry practice. The limitation on the value of e-M to be accepted in exchange for cash at any one time is raised from EUR 150 to EUR 500 (Article 16).

3.6.5 The EMD allowed Member States to waive many of the authorisation requirements to facilitate market entry and innovation by new players. These waivers were applied inconsistently by Member States, creating an uneven playing field for market participants. Under the new regime waivers continue (Article 10) but, as specified in the relevant articles of the PSD, e-M institutions subject to waivers are not to operate across Member State borders. In other words, no 'Passporting' where waivers apply.

#### 4. The economic and social perspective

4.1 The EESC is very interested in progress towards the goals of the Lisbon project. This Directive deserves our support because it supports the Lisbon goals of growth and jobs to be achieved by, inter alia, technological innovation, entrepreneurial initiative, creativity on the internet and the formation of SMEs leading to the development of the 21st century e-society.

4.2 The introduction of a new regulatory regime in the financial sector is a potential issue in view of the crisis in the banking system and the general concern about the ineffectiveness of the regulation of banks. Notwithstanding these concerns, the EESC is satisfied that the proposed regime is adequate and proportionate for the following reasons:

- The regulations are designed for the innovative SMEs of the payments community. The recent banking crisis arose from the credit exposures of the banks. E-M institutions will not be permitted to issue credit based on user funds so that risk does not arise.
- The own funds requirement (paras 3.6.1 and 3.6.2 above) makes the initial capital of EUR 125k rise proportionally with increased float value. The drop in the initial capital requirement only serves to reduce the barriers to entry. The Directive specifies significant capital requirements for larger floats.
- The capital reserves an e-M Institution will be proportional to those of the banks and funds representing user claims

will be specifically safeguarded in a limited range of investments.

- The amounts of money involved are de minimis. Should e-M institutions become a real force in the payments market, there are provisions in the Directive to modify it in the light of experience.

4.3 The EESC has some concerns about consumer protection and it urges the Commission to make the following changes to the Directive:

4.3.1 Limitations on the investment of the float only apply at the moment to hybrid e-M Institutions. For the greater security of clients, these provisions should apply to all e-M Institutions.

4.3.2 E-M Institutions may not hold client moneys as deposits.. Monies received should be immediately converted into e-M. This safeguard is not spelled out in the Directive.

4.3.3 Article 9 should be amended to make explicit the requirement that the float in respect of outstanding e-M obligations should be specifically safeguarded by hybrid institutions.

4.3.4 Article 5.4 allows for no fee to be charged for redemption at the termination of a contract but Article 5.5 allows a fee to be charged for early termination. This latter provision should be removed because there is no distinction between redemption during and at the end of the contract and the outcome is likely to be a pattern of contract terminations which will mitigate against the prudential requirement to know the client.

4.4 Attitudes towards cash vary across the different cultures in the EU, and so do attitudes towards technology. Email and internet take up rates can provide some measure of the likely acceptance of e-M. Another factor will be the demography of the retail and services industries. Larger companies are more likely to accept e-M as early adopters. For these and other reasons relating to Member State psyche, it would be unwise to expect e-M take up at a uniform rate across the EU.

4.5 Of the 20 or so e-M institutions accredited to date, some 15 have been accredited in the UK. The positive policy of the UK Financial Services Authority towards e-M has contributed to this outcome. In particular, the FSA consulted the industry to ensure that the UK regulations were workable in practice. In this they were successful. The EESC urges all Member State to adopt equally positive policies in respect of the new Directive. Such policies should contribute to increasing the acceptance of e-M across the EU.

4.6 A fundamental concern relates to the development of anti money laundering regulations. The Third AML Directive contained an Article which gave Member States the freedom not to apply Customer Due Diligence measures, or to postpone them, in respect of electronic money (Simplified CDD) when the amount stored is no more than EUR 150 in a device which cannot be recharged or no more than EUR 2 500 per calendar year in a rechargeable device. The equivalent limits in both the PSD and proposed revision of the EMD are EUR 500 and 3 000. The EESC cannot accept that two directives set contradictory limits. This creates unacceptable legal confusion. If the limits stated in this directive are to prevail, then the AML Directive must be modified.

4.7 Cash is anonymous. Simple cash transactions do not reveal the identity of the person making the payment. e-M

schemes may be anonymous or identified. A problem with Member State implementation of the EMD was that it often took KYC (know your client) to extremes. For low value transactions, many users will wish to preserve their anonymity. It was a feature of the UK implementation of the EMD that KYC measures did not come into play until a client had developed a material level of activity. The higher stored value limit of EUR 500 should make e-M more attractive to potential users, especially the unbanked and underbanked. While rationally these limits should not represent a disproportionate exposure to money laundering, relative to what is possible with large sums of cash, there remain some reservations about the limit proposed.

4.8 Financial inclusion is facilitated by e-M. In a society which increasingly assumes that payment will be made by debit card or credit card, the possibility of acquiring a card for cash which can then be used in credit and debit transactions is potentially very attractive. Certain groups in society could be particularly advantaged by this facility. These include immigrants, the unbanked or underbanked and, in certain circumstances, the young and the disabled. The EESC is concerned that from a consumer protection point of view, these groups are also the most vulnerable. Member States should take account of these vulnerabilities when they implement the Directive.

Brussels, 26 February 2009.

The President  
of the European Economic and Social Committee  
Mario SEPI

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